No. 8429

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.//

FEDERAL HOUSING ADMINISTRATOR, on Behalf of the United States of America,

Appellant,

vs.

WM. H. MOORE, Jr., as Trustee in Bankruptcy of the Estate of PIONEER AUTO LAUNDRY, a Corporation, Bankrupt,

Appellee.

BRIEF OF APPELLANT

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SUBJECT INDEX

CITATIONS AND AUTHORITIES

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Opinion Below

Order of Referee in Bankruptcy disallowing claim of the Federal Housing Administrator on behalf of the United States as a prior claim and allowing same as a general claim appears on pages 20-21, Transcript of Record. Referee's Certificate of Review, pages 23-29, Transcript of Record. The opinion of Honorable Wm. P. James affirming the order of the Referee in Bankruptcy at pages 29-30, Transcript of Record.

Jurisdiction

This appeal involves the status of the Federal Housing Administrator and a claim filed against the bankrupt estate of the Pioneer Auto Laundry, a corporation, by said Federal Housing Administrator on behalf of the United States and whether said claim so filed is a preferred or general claim, said claim being for the sum of $1,579.78. (R. 4-6.) The judgment of the District Court was entered on the 16th day of October, 1936. (R. 29-30.) Petition for Appeal, Assignments of Error and Order of the District Judge allowing said appeal were filed on October 26, 1936. (R. 33-36.) On November 17, 1936, Hon. Wm. P. James on stipulation of counsel made an order extending time within which to file Transcript of Record or statement in lieu of record and for docketing said cause in the Circuit Court of Appeals for the Ninth Circuit, to December 31, 1936. Jurisdiction of the court is invoked by virtue of the provisions of Sections 24 and 25 of the *Bankruptcy Act* as amended, Sections 47 and 48, Title 11, *U. S. C. A.*

Questions Presented

1. Whether the Federal Housing Administration is an independent entity and has no sovereign attributes of the United States;

2. Whether the debt in the sum of $1,579.78 is due and owing to the Federal Housing Administration or to the United States;

3. Whether said claim should have been allowed as a general claim or a preferred claim.

Statutes Involved

The *National Housing Act*, Title 12, Sections 1702, 1703, 1705, and 3466 of the *Revised Statutes;* 31 *U. S. C. A.*, Section 191.

Statement

This cause was submitted to the United States District Court pursuant to a petition for review of an order of the Referee in Bankruptcy, dated the 17th day of June, 1936, finding that the Federal Housing Administration is an independent entity, that it has no sovereign attributes of the United States, that said debt represented in the claim in the sum of $1,579.78 was due and owing to the Federal Housing Administration and not to the United States, and therefore was entitled to be allowed only as a general claim and that said claim was disallowed as a prior claim but allowed as a general unsecured claim in said sum of $1,579.78. (R. 20-21.)

An agreed statement of the case in lieu of record pursuant to Equity Rule 77 was prepared and filed herein. (R. 3-32.) That on December 21, 1934, said Pioneer Auto Laundry executed a Modernization Loan Note in the sum of $2,000.00 to the Seaboard National Bank of Los Angeles and subsequently defaulted in its monthly payments, and the Seaboard National Bank of Los Angeles duly filed its claim with the Federal Housing Administrator, which claim was paid in full on September 27, 1935, in the sum of $1,579.78, said Seaboard National Bank of Los Angeles then assigned all its right, title and interest in and to said defaulted obligation to the

Federal Housing Administrator, acting for and on behalf of the United States. (R. 5.)

Specification of Errors to be Urged

The appellant made and filed the following Assignments of Error which are urged in this court as grounds for reversal of the judgment below. (R. 35-36.)

I.

"The Court erred in affirming the Order of the Referee in Bankruptcy dated June 17, 1936, by which order of the Referee it was found that the Federal Housing Administration is an independent entity and that it has no sovereign attributes of the United States of America."

II.

"The Court erred in affirming the finding of the Referee in Bankruptcy that the claim of the Federal Housing Administrator was not a claim on behalf of the United States, and was entitled to be allowed only as a general claim."

III.

"The Court erred in not reversing the decision of the Referee in Bankruptcy of June 17, 1936, that said claim was not a preferred claim of the United States of America."

Argument

The debtor Pioneer Auto Laundry, a corporation, applied to the Seaboard National Bank for a Federal Housing Administration loan and was charged with complete knowledge of the provisions of that Act as is shown by

letter of the bankrupt to Seaboard National Bank when application for said loan was made together with Home Modernization Loan note. There is in the agreed statement of the case in lieu of record a property owner's printed statement dated December 12, 1934, and photostatic copy of the note of December 12, 1934, bearing the assignment to the Federal Housing Administrator from the Seaboard National Bank of Los Angeles, together with photostatic copy of worksheet showing how the claim was approved for payment in the sum of $1,579.78. (R. 11-18.)

The note in question has printed on the margin "Home Modernization Loan," and the exhibits filed with said claim show that under the Federal Housing Administration Act default was made in the May 21, 1935, payment and ipso facto the United States through its Federal Housing Administrator became liable to the Seaboard National Bank for the amount of principal and interest due from said Pioneer Auto Laundry to Seaboard National Bank of Los Angeles.

Your attention is directed to Section 1702 of Title 12, *U. S. C. A.*, providing:

> "The President is authorized to create a Federal Housing Administration, all of the powers of which shall be exercised by a Federal Housing Administrator (hereinafter referred to as the 'Administrator'), who shall be appointed by the President, by and with the advice and consent of the Senate, shall hold office for a term of four years and shall receive compensation at the rate of $10,000 per annum. In order to carry out the provisions of this title and

titles II and III of this Chapter the Administrator may establish such agencies, accept and utilize such voluntary and uncompensated services, utilize such Federal officers and employees, and, with the consent of the State, such State and local officers and employees, and appoint such other officers and employees as he may find necessary, and may prescribe their authorities, duties, responsibilities, and tenure and fix their compensation, without regard to the provisions of other laws applicable to the employment or compensation of officers or employees of the United States. The Administrator may delegate any of the functions and powers conferred upon him under this title and titles II and III of this chapter to such officers, agents, and employees as he may designate or appoint, and may make such expenditures (including expenditures for personal services and rent at the seat of government and elsewhere, for law books and books of reference, and for paper, printing, and binding) as are necessary to carry out the provisions of this title and titles II and III of this chapter, without regard to any other provisions of law governing the expenditure of public funds * * *."

Sub-division (a) of Section 1703 provides that—

"The Administrator is authorized and empowered, upon such terms and conditions as he may prescribe, to insure banks, trust companies, personal finance companies, mortgage companies, building and loan associations, installment lending companies, and other such financial institutions, which the Administrator finds to be qualified by experience or facilities and approves as eligible for credit insurance, * * *."

Section 1705 provides:

> "For the purposes of carrying out the provisions of this title and titles II and III of this chapter, the Reconstruction Finance Corporation shall make available to the Administrator such funds as he may deem necessary, and the amount of notes, debentures, bonds, or other such obligations which the Corporation is authorized and empowered to have outstanding at any one time under existing law is hereby increased by an amount sufficient to provide such funds: Provided, That the President, in his discretion, is authorized to provide such funds or any portion thereof by allotment to the Administrator from any funds that are available, or may hereafter be made available, to the President for emergency purposes."

All this means that the money loaned by the Administration (the Administrator) is the funds of the United States, whether that money was procured by the Administrator in his official capacity from the Reconstruction Finance Corporation or from funds that are available to the President for emergency purposes. We respectfully refer to Pioneer Auto Laundry's letter of December 12, 1934, to Seaboard National Bank on page 14 of the Transcript of Record which sets forth:

> "Attached Form 3, property owner's statement, for the purpose of securing a modernization credit through the Federal Housing Administration."

The debtor, as all applicants under said Federal Housing Administration Act, made application for a loan with full knowledge of the fact that it was dealing not only

with the bank but with the Federal Housing Administrator on behalf of the United States. In the case of *Howe v. Sheppard*, decided by Justice Story while on the Circuit Court (2 Sumn. 133), the Court upholds the right of the United States to priority in the case of a private debt of an insolvent debtor assigned to the United States.

Howe and Howard obtained a judgment for $4,663.31 against one Wood. The United States had recovered judgments against the firm on certain bonds given to secure the payment of debts. In part satisfaction of these judgments the firm assigned the Wood judgment to the United States in September, 1830. In December, 1830, the United States, in the name of Howe and Howard, brought an action against Wood on this judgment. Wood was notified thereof in March, 1831, when the return was served on him. The action was continued from time to time and in October, 1834, Wood died. In November, 1834, administration was granted but the estate was insolvent. In December, 1834, the United States notified the administrator of the suit against Wood and claimed priority of payment of such judgment as should be rendered in this suit. This action was submitted to the Circuit Court, the administrator arguing that he, as an administrator of Howe's estate, was not a debtor to the United States within the meaning of the Insolvency Statute because it did not appear of record that he was a debtor to the United States nor was there an express promise by defendant to pay this debt to the United States, and the latter stands only in the place of the assignor. However, Justice Story held that:

"* * * The assignment of the judgment did in equity transfer the debt to the United States; and the Government might, by a bill in equity, have enforced the judgment against the debtor. The question, then, comes to this, whether the Statute of 1797, Chapter 74, giving priority to the Government in payment of debts, applies to legal debts only, or to debts both legal and equitable * * *. The words of the Statute seem to extend to all cases of debts due to the United States from an insolvent debtor's estate; and if payable at all out of his assets, the rule of priority seems co-extensive with the duty of the executor or administrator to pay.

"* * * Suppose an estate solvent as to the payment of legal debts, but not as to the payment of equitable debts also, can it be treated as other than an insolvent estate? And, if insolvent, are not the United States necessarily entitled to a priority as to all their debts by the very terms of the Statute?

"After reflecting much upon the subject, I am unable to arrive at any other conclusion, than that the priority of the United States attaches to all debts, equitable, as well as legal * * *."

See also:

Bramwell v. U. S. F. & G. Co., 269 U. S. 483;
Price v. U. S., 269 U. S. 492

Priority Thereof Inherent in Sovereignty Depends Upon Statute

It is immaterial whether the debt is contracted in a "business transaction," as distinguished from an "action of sovereignty." Priority is given by the statute and not

because of any reliance upon the assertion of sovereign powers.

> "The right of priority of payment of debts due to the government is a prerogative of the Crown well known to the common law. It is founded not so much upon any personal advantage to the sovereign as upon motives of public policy, in order to secure an adequate revenue to sustain the public burdens and discharge the public debts. The claim of the United States, however, does not stand upon any sovereign prerogative, but is exclusively founded upon the actual provisions of their own statutes. The same policy which governed in the case of the royal prerogative may be clearly traced to these statutes, and as that policy has mainly a reference to the public good, there is no reason for giving to them a strict and narrow interpretation. Like all other statutes of this nature, they ought to receive a fair and reasonable interpretation, according to the just import of their terms." (Justice Story in *United States v. State Bank of North Carolina*, 6 Pet. 29, 35.)

In *Whan v. Green Star S. S. Corp.*, 22 Fed. (2d) 483; 276 U. S. 629, the United States filed a priority claim in a receivership proceeding involving a steamship corporation, the claim being based upon notes payable to "the United States of America, or order," which notes were given in part payment for a ship sold to it by the Emergency Fleet Corporation, as agent of the United States. The remainder of the purchase price was paid in cash to the Treasury of the United States. It was urged that the sale was made in an ordinary business transaction and,

therefore, the United States was not entitled to priority. The court said that the priority was granted by statute, and applied in this case even assuming that the United States divested itself of sovereignty when it acted through the Emergency Fleet Corporation.

Public Policy

The purpose of the statute giving priority to the United States in the case of debts due from an insolvent is to protect the credit and finances of the United States. *United States v. State Bank of North Carolina,* 6 Pet. 29, 35; *Price v. U. S.*, 269 U. S. 492. The inequity of individual cases cannot be argued as a ground for construing the statute in a manner which would contradict its plain import. It may be argued, in cases in which the United States claims priority as assignee of obligations of an insolvent debtor, insured under Title I of the National Housing Act, that to allow such a priority would be contrary to public policy because it would be taking an unfair advantage of other creditors who could know nothing of this contingency.

> "A man may have indorsed a hundred bills, and he may not himself know how many of them have been purchased by the United States. His creditors trust him without notice; they believe that if any accident should happen to him, they will share an equal fate with his other creditors. If they had known as in the case of a collector, that the United States might come in and seize the whole of his effects, they would not have given him credit. Such a construction ought to be supported by the strongest reasons." (*U. S. v. Fisher,* 2 Cranch 358, 369.)

To this argument Justice Marshall replied:

"The mischiefs to result from the construction on which the United States insist, have been stated as strong motives for overruling that construction. That the consequences are to be considered in expounding laws, where the intent is doubtful, is a principle not to be controverted; but it is also true that it is a principle which must be applied with caution, and which has a degree of influence dependent on the nature of the case to which it is applied. Where rights are infringed, where fundamental principles are overthrown, where the general system of the laws is departed from, the legislative intention must be expressed with irresistible clearness to induce a court of justice to suppose a design to effect such objects. But where only a political regulation is made, which is inconvenient, if the intention of the legislature be expressed in terms which are sufficiently intelligible to leave no doubt in the mind when the words are taken in their ordinary sense, it would be going a great way to say that a constrained interpretation must be put upon them, to avoid an inconvenience which ought to have been contemplated in the legislature when the act was passed, and which, in their opinion, was probably overbalanced by the particular advantages it was calculated to produce.

"Of the latter description of inconveniences are those occasioned by the act in question. It is for the legislature to appreciate them. They are not of such magnitude as to induce an opinion that the legislature could not intend to expose the citizens of the United States to them, when words are used which manifest that intent.

> "On this subject it is to be remarked, that no lien is created by this law. No bona fide transfer of property in the ordinary course of business is overreached. It is only a priority in payment, which, under different modifications, is a regulation in common use; * * *." (*U. S. v. Fisher*, 2 Cranch 358, 389-390.)

It may also be urged that the true creditor is not the United States, but the institution which made the loan, and that to allow the United States a priority would open the door to collusion. A similar argument was made in *Howe v. Sheppard, supra*, where creditors complained that if the United States could claim a priority in the case of a debt obtained upon assignment, it could also buy up claims and take a priority, and other improper practices would be possible, but Justice Story ignored the point.

Section 3466 of the *Revised Statutes*, 31 *U. S. C. A.*, Section 191, provides that:

> "Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

The priority of the United States, in cases of the bankruptcy or insolvency of its debtors extends to all classes of cases.

United States v. Barnes, 31 Fed. 705-709.

So far as we are concerned with contingent claims of the United States which are based upon obligations insured by the Federal Housing Administrator under Title I of the National Housing Act, there is nothing to indicate that Congress did not intend to allow priority to obligations of an insolvent debtor, coming into the possession of the United States as a result of such insurance. Moreover, the operation of the Federal Housing Administration under the National Housing Act will not be affected adversely if the United States is given priority. It may, to the contrary, be argued that to give priority to such debts accords with the purpose of Congress to provide credit for repairs and improvement to real property at the least possible cost to the United States.

It would be as ridiculous to contend that any other Federal officials appointed by the President with the advice and consent of the Senate are not Federal officials, and do not perform direct official acts of the United States Government, as to contend that the Federal Housing Administrator is a separate and distinct entity and is more on the order of quasi-Federal corporations such as national banks, Reconstruction Finance Corporation and the Home Owners' Loan Corporation.

Conclusion

It is submitted that the order of the lower court confirming the determination of the referee should be reversed and the case remanded, with instructions that the Government's claim should be allowed as a preferred claim.

Respectfully submitted,

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